



STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Financial Statements

June 30, 2003 and 2002

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

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Independent Auditors' Report

Division of Retirement and Benefits
Retiree Health Fund:

We have audited the accompanying statements of fiduciary net assets of the State of Alaska Retiree Health Fund (Plan), a Pension Trust Fund of the State of Alaska, as of June 30, 2003 and 2002, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the State of Alaska Retiree Health Fund and do not purport to and do not present fairly the financial position of the State of Alaska as of June 30, 2003 and 2002, changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting standards generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Retiree Health Fund (Plan), a Pension Trust Fund of the State of Alaska, as of June 30, 2003 and 2002, and the changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying required supplementary information of management's discussion and analysis on pages 2 to 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 26, 2003



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STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)
Management's Discussion and Analysis

This section presents management's discussion and analysis (MD&A) of the Retiree Health Fund's (Plan) financial condition and performance for the years ended June 30, 2003 and 2002. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to the financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2003 and 2002. Prior fiscal years' information is presented for comparative purposes.

Financial Highlights

The Plan's total current assets exceeded its total current liabilities by \$144,870,131 and \$110,229,934 at the close of Fiscal Years 2003 and 2002, respectively.

The Plan's net assets as of June 30, 2003 and 2002 increased by \$34,640,197 and \$32,781,287 or 31.4% and 42.3% over the closing balances of those assets in Fiscal Years 2002 and 2001, respectively.

Total health premiums received totaled \$240,750,515 and \$211,198,112 during Fiscal Years 2003 and 2002, respectively; increases of \$29,552,403 and \$30,383,922 or 14.0% and 16.8% from Fiscal Years 2002 and 2001, respectively.

Investment earnings increased from \$952,373 to \$9,514,374 during Fiscal Year 2003 and decreased from \$1,863,023 to \$952,373 during Fiscal Year 2002; reflecting an increase of 899.0% and a decrease of 48.9% from Fiscal Years 2002 and 2001, respectively.

Benefit payments totaled \$206,176,251 and \$170,878,815 during Fiscal Years 2003 and 2002, respectively; increases of \$35,297,436 and \$23,592,836 or 20.7% and 16.0% from Fiscal Years 2002 and 2001, respectively.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's basic financial statements are comprised of three components: (1) statement of fiduciary net assets, (2) statement of changes in fiduciary net assets, and (3) notes to the financial statements.

Statement of Fiduciary Net Assets – This statement presents information regarding the Plan's assets, liabilities, and net assets. Net assets represent the total amount of assets less the total liabilities. The Statement of Fiduciary Net Assets classifies assets, liabilities and net assets as current, non-current and restricted.

Statement of Changes in Fiduciary Net Assets – This statement presents how the Plan's net assets changed during the fiscal year as a result of contributions, investment income (loss), operating expenses, and changes in net assets.

The above statements represent resources available for investment and the payment of benefits as of the fiscal year-end and the sources and uses of those funds during the fiscal year.

Notes to the Financial Statements – The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules to better understand the Plan's financial statements.

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Management's Discussion and Analysis

Condensed Financial Information

RETIREE HEALTH FUND
NET ASSETS

| <u>Description</u> | <u>2003</u> | <u>2002</u> | <u>Increase/(Decrease)</u> <u>Amount</u> | <u>%</u> | <u>2001</u> |
|--|-----------------------|--------------------|---|--------------|-------------------|
| Assets: | | | | | |
| Cash and receivables | \$ 48,078,572 | 36,988,373 | 11,090,199 | 30.0% | 27,547,369 |
| Investments, at fair value | 137,964,954 | 112,790,365 | 25,174,589 | 22.3% | 89,662,935 |
| Total assets | 186,043,526 | 149,778,738 | 36,264,788 | 24.2% | 117,210,304 |
| Liabilities: | | | | | |
| Estimated claims incurred but not paid | 38,750,000 | 38,030,000 | 720,000 | 1.9% | 37,086,000 |
| Accrued expenses | 1,217,771 | 508,027 | 709,744 | 139.7% | 1,395,397 |
| Other liabilities | 1,205,624 | 1,010,777 | 194,847 | 19.3% | 1,280,260 |
| Total liabilities | 41,173,395 | 39,548,804 | 1,624,591 | 4.1% | 39,761,657 |
| Total net assets | \$ 144,870,131 | 110,229,934 | 34,640,197 | 31.4% | 77,448,647 |

CHANGES IN NET ASSETS

| | | | | | |
|--------------------------------------|-----------------------|--------------------|-------------------|--------------|-------------------|
| Net assets, beginning of year | \$ 110,229,934 | 77,448,647 | 32,781,287 | 42.3% | 51,039,314 |
| Additions: | | | | | |
| Health insurance premiums | 240,750,515 | 211,198,112 | 29,552,403 | 14.0% | 180,814,190 |
| Net investment income | 9,514,374 | 952,373 | 8,562,001 | 899.0% | 1,863,023 |
| Total additions | 250,264,889 | 212,150,485 | 38,114,404 | 18.0% | 182,677,213 |
| Deductions: | | | | | |
| Benefits | 206,176,251 | 170,878,815 | 35,297,436 | 20.7% | 147,285,979 |
| Administrative expenses | 9,448,441 | 8,490,383 | 958,058 | 11.3% | 8,981,901 |
| Total deductions | 215,624,692 | 179,369,198 | 36,255,494 | 20.2% | 156,267,880 |
| Increase in net assets | 34,640,197 | 32,781,287 | 1,858,910 | 5.7% | 26,409,333 |
| Net assets, end of year | \$ 144,870,131 | 110,229,934 | 34,640,197 | 31.4% | 77,448,647 |

Financial Analysis of the Plan

The Statements of Fiduciary Net Assets at the close of June 30, 2003 and 2002 showed total assets exceeding total liabilities by \$144,870,131 and \$110,229,934, respectively. These amounts represent the total plan assets held in trust for postemployment healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligations to pay benefits for its members and their beneficiaries.

These amounts also represent increases in net assets of \$34,640,197 and \$32,781,287, or 31.4% and 42.3% from Fiscal Years 2002 and 2001, respectively. Over the long term, health premiums collected are expected to cover all claims costs to the Plan. With continued increases in health care costs, the Plan must continue to accrue assets that are available to meet current and future claims costs.

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Management's Discussion and Analysis

The investment of Plan funds is a long-term undertaking. On an annual basis, the Commissioner of Revenue reviews the asset allocation policies of the Retiree Major Medical and Retiree Long Term Care funds and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/reward level given the Plan's constraints and objectives. During Fiscal Years 2003 and 2002, the Department of Revenue allocated Retiree Major Medical assets in the following manner: 30% in the Short-term Fixed Income Pool, 30% in the Intermediate-term Fixed Income Pool, and 40% in the Broad Market Fixed Income Pool. Long Term Care assets were allocated in the following manner: 36% in the Broad Market Fixed Income Pool, 19% in the State of Alaska International Equity Pool, and 45% in the Non-retirement Domestic Equity Pool.

Premium Calculations

The overall objective of the health fund is to have sufficient funds to meet claim costs for the retiree health plans. The premiums are set each year by the Division's benefit consultant with the Division's and Boards' concurrence. Premiums are based on a calendar year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next calendar year.

Health Insurance Premiums and Investment Income

The revenues required to finance postemployment healthcare benefits are accumulated through a combination of pension system health premiums and member health premiums and investment income.

| | | Revenues | | | | |
|--------------------------|-----------|--------------------|--------------------|---------------------|--------------|--------------------|
| | | FY03 | FY02 | Increase/(Decrease) | | FY01 |
| | | | | Amount | % | |
| Employer health premiums | \$ | 210,073,525 | 182,500,902 | 27,572,623 | 15.1% | 153,380,972 |
| Member health premiums | | 30,201,841 | 27,643,597 | 2,558,244 | 9.3% | 25,287,664 |
| Other | | 475,149 | 1,053,613 | (578,464) | (54.9%) | 2,145,554 |
| Net investment income | | 9,514,374 | 952,373 | 8,562,001 | 899.0% | 1,863,023 |
| Total | \$ | 250,264,889 | 212,150,485 | 38,114,404 | 18.0% | 182,677,213 |

Health premiums increased from \$610 per year per person during calendar year 2001 to \$668 per year per person during calendar year 2002 to \$720 during calendar year 2003. Investment income increased by \$8,562,001 or 899.0% over amounts recorded in Fiscal Year 2002, thereby providing a substantial boost to increase net assets of the Plan over the same period. Investment income decreased by \$910,650 or 48.9% over amounts recorded in Fiscal Year 2001. While it was a decrease, there was still a modest return on the Plan's assets. Other income decreased as the Plan did not receive as much in prescription drug rebates as in the two previous years.

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Benefits and Expenses

The primary expense of the Plan is the payment of postemployment healthcare benefits. These benefit costs and the cost of administering the Plan comprise the costs of operation.

| | | Expenses | | | |
|-------------------------|-----------------------|--------------------|---------------------------------------|--------------|--------------------|
| | FY03 | FY02 | Increase/(Decrease) Amount | % | FY01 |
| Healthcare benefits | \$ 206,176,251 | 170,878,815 | 35,297,436 | 20.7% | 147,285,979 |
| Administrative expenses | 9,448,441 | 8,490,383 | 958,058 | 11.3% | 8,981,901 |
| Total | \$ 215,624,692 | 179,369,198 | 36,255,494 | 20.2% | 156,267,880 |

Benefit payments had increases of \$35,297,436 and \$23,592,836 or 20.7% and 16.0% from Fiscal Years 2002 and 2001, respectively. With health care cost continuing to trend higher as well as increases in the number of retirees each fiscal year, further increases to healthcare benefit payments are expected. The Plan's benefit consultants had identified and developed premiums necessary to cover the increased claims costs.

Funding

Postemployment healthcare benefits are funded by premiums received from the respective retirement systems and plan members as well as from income earned on the Plan's investments. Health premiums are determined by the Division's benefit consultant and approved by the retirement systems' governing boards.

Economic Conditions, Market Environment, and Results

There are three plans financed through the Retiree Health Fund: major medical (mostly paid by the respective retirement funds), the Dental-Vision-Audio (DVA) and Long-Term Care (LTC) plans (both paid for by the retirees only). The overall objective of the Plan is to have sufficient funds to meet current and future claim costs for the retiree health plans. The premiums for the major medical and DVA plans are calculated each year based on the anticipated claims and administrative costs for the following year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next calendar year. The amount of restricted and unrestricted reserves is considered when setting the premiums. The premiums for the LTC plan have been developed to provide future benefits for the retirees, much like an annuity. The LTC plan will be accruing large reserves to pay future benefits.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for all those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State of Alaska, Division of Retirement & Benefits, Accounting Section, P.O. Box 110203, Juneau, Alaska 99811-0203.

STATE OF ALASKA
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Statements of Fiduciary Net Assets

June 30, 2003 and 2002

| | <u>2003</u> | <u>2002</u> |
|---|-----------------------|--------------------|
| Current assets: | | |
| Cash and cash equivalents: | | |
| Investment in State of Alaska General Fund and other | | |
| non-segregated investments pool (notes 3 and 6) | \$ 11,983,885 | 9,916,517 |
| Short-term fixed income pool | <u>35,987,161</u> | <u>26,954,744</u> |
| Total cash and cash equivalents | 47,971,046 | 36,871,261 |
| Investments (notes 3 and 4): | | |
| Broad market fixed income pool | 64,197,430 | 54,676,360 |
| Non-retirement domestic equity pool | 30,093,174 | 21,779,771 |
| Intermediate-term fixed income pool | 30,843,528 | 26,081,366 |
| State of Alaska international equity pool | <u>12,830,822</u> | <u>10,252,868</u> |
| Total investments | <u>137,964,954</u> | <u>112,790,365</u> |
| Premiums receivable | 101,963 | 91,414 |
| Due from retirement systems | <u>5,563</u> | <u>25,698</u> |
| Total assets | <u>186,043,526</u> | <u>149,778,738</u> |
| Current liabilities: | | |
| Estimated claims incurred but not paid (note 5): | | |
| Medical, dental, visual and audio | 31,550,000 | 31,510,000 |
| Long-term care | <u>7,200,000</u> | <u>6,520,000</u> |
| Total estimated claims incurred but not paid | 38,750,000 | 38,030,000 |
| Accrued expenses | 1,217,771 | 508,027 |
| Due to other funds | 48 | — |
| Due to State of Alaska General Fund | <u>1,205,576</u> | <u>1,010,777</u> |
| Total liabilities | <u>41,173,395</u> | <u>39,548,804</u> |
| Contingency (note 7) | | |
| Held in trust for pension benefits and other purposes: | | |
| Major medical | 74,506,214 | 53,805,631 |
| Dental, visual and audio | 9,994,539 | 8,204,199 |
| Long-term care | <u>60,369,378</u> | <u>48,220,104</u> |
| Total net assets held in trust for postemployment healthcare benefits and other purposes | <u>\$ 144,870,131</u> | <u>110,229,934</u> |

See accompanying notes to basic financial statements.

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Statements of Changes in Fiduciary Net Assets
Years ended June 30, 2003 and 2002

| | <u>2003</u> | <u>2002</u> |
|--|-----------------------|--------------------|
| Additions: | | |
| Contributions: | | |
| Employer health insurance premiums | \$ 210,073,525 | 182,500,902 |
| Member health insurance premiums | 30,201,841 | 27,643,597 |
| Other | 475,149 | 1,053,613 |
| Total contributions | <u>240,750,515</u> | <u>211,198,112</u> |
| Investment income: | | |
| Net appreciation (depreciation) in fair value of investments (note 3) | 3,301,060 | (4,623,432) |
| Interest | 5,578,703 | 5,101,950 |
| Dividends | 694,811 | 527,055 |
| Total investment income | <u>9,574,574</u> | <u>1,005,573</u> |
| Less investment expense | 60,200 | 53,200 |
| Net investment income | <u>9,514,374</u> | <u>952,373</u> |
| Total additions | <u>250,264,889</u> | <u>212,150,485</u> |
| Deductions: | | |
| Benefits | 206,176,251 | 170,878,815 |
| Administrative expenses | 9,448,441 | 8,490,383 |
| Total deductions | <u>215,624,692</u> | <u>179,369,198</u> |
| Change in fiduciary net assets | 34,640,197 | 32,781,287 |
| Net assets, beginning of year | <u>110,229,934</u> | <u>77,448,647</u> |
| Net assets, end of year | <u>\$ 144,870,131</u> | <u>110,229,934</u> |

See accompanying notes to basic financial statements.

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RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2003 and 2002

(1) Description

The following brief description of the State of Alaska Retiree Health Fund (Plan), a pension trust fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

(a) General

The Plan was established to provide self-insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is a pension trust fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2003 and 2002, there were approximately 24,800 and 23,400 retirees, respectively, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for retirees were fully insured through the payment of premiums to an insurance company.

(b) Benefits

The Plan offers major medical, voluntary dental-visual-audio (DVA) and voluntary long-term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

Medical

The Plan provides medical benefits to qualified benefit recipients of the Retirement Systems. The Retirement Systems pay the medical premiums for the benefit recipients,, except for the following who must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) if they were first hired under the PERS on or after July 1, 1986, who are under age 60, are not receiving a disability benefit, and had less than 25 years of police/fire service or less than 30 years of other service.
- Benefit recipients of the Teachers' Retirement System (TRS) if they were first hired under the TRS on or after July 1, 1990, who are under age 60, are not receiving a disability benefit, and had less than 25 years of service.
- Benefit recipients of the PERS if they were first hired under the PERS on or after July 1, 1996, who are age 60 or older and do not have at least 10 years of credited service.
- Alternate payees under a Qualified Domestic Relations Order (QDRO).

The State also pays the medical premiums for benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986.

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Voluntary DVA and LTC

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

(c) Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, Aetna, to process all medical, dental, and prescription drug claims.

(d) Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from the Retirement Systems and benefit recipients, as applicable. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The Retirement Systems retain the risk of loss of allowable claims.

Amounts due to the State of Alaska General Fund represent reimbursements to be made by the Plan to other funds for net payments made by other plans on behalf of the Plan

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The Plan's financial statements are prepared using the economic resource focus and the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than in a forced or liquidation sale."

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The Plan is a participant in the State's General Fund and Other Non-Segregated Investments (GeFONSI) pool. GeFONSI is comprised of the invested assets of the State General Fund and certain other funds that are commingled for investment purposes. GeFONSI invests primarily in pooled marketable debt securities. Investment income is distributed to pool participants as prescribed by statute or if appropriated by the State legislature.

The custodial agent determines the fair value of pooled marketable debt investments each business day using an independent pricing service. Fair value of debt securities has been established as the midpoint between the bid and asked prices.

For equities traded on a national or international exchange, the custodial agent uses independent pricing services each business day to determine the fair value at the last reported sale price as of the close of business or, in the absence of any sales price, at the last reported bid price. Equities not traded on a national or international exchange are based on equivalent values of comparable securities with interest rates for similar instruments. The cost of debt and equity investments is determined on the average cost basis.

Each business day the Trustee Committee determines the net asset value per share for the non-retirement domestic equity pool. The net asset value per share is determined by dividing the fair value of its underlying assets by the number of units that represent total ownership. The value of underlying securities held is determined in good faith and pursuant to procedures established by the Trustee.

Realized gains and losses resulting from the sale of securities are accounted for on a trade date (ownership) basis at the current fair value described above. Changes in unrealized gains and losses are calculated daily based on the fair value described above.

Income from pooled marketable debt and equity securities, which includes interest, dividends, and realized and unrealized gains and losses, is calculated and credited daily to each participant on a pro rata basis.

(d) Federal Income Tax Status

The Plan is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code.

(e) GASB Statement No. 34

The Plan adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34) on July 1, 2001, concurrent with the State of Alaska's adoption of GASB No. 34. This statement, known as the "reporting model" statement, affects the way the Plan presents financial information. GASB No. 34 requires the basic financial statements of fiduciary funds to include statements of fiduciary net assets and statements of changes in fiduciary net assets. These statements are required to be accounted for on the current financial resources measurement focus and the modified accrual basis of accounting. Modifications made to the Plan's financial reporting model as a result of the adoption of GASB No. 34 include presentation of management's discussion and analysis

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(as required supplementary information), presentation of assets and liabilities in a classified format, and reclassification of net assets according to certain criteria. The adoption of GASB No. 34 had no cumulative effect on net assets.

(3) Investments

The Governmental Accounting Standards Board (GASB) Statement No. 3 requires disclosure regarding custodial credit risk to indicate the chance of loss in the event a financial institution or third-party holding the Plan's deposits or securities fails. Deposits and those investments represented by specified, identifiable securities are classified into three categories of credit risk: Category 1 – Insured or registered, or securities held by the State or its custodian in the State's name; Category 2 – Uninsured or unregistered, with securities held by the counterparty's trust department (if a bank) or agent in the State's name; and Category 3 – Uninsured and unregistered, with securities held by the counterparty, or by its trust department (if a bank) or agent, but not in the State's name.

Certain types of investments are not subject to the custodial credit risk disclosure requirements in GASB Statement No. 3. The short-term fixed income pool, broad market fixed income pool, and SOA international equity pool contain assets of other participants outside the reporting entity and, as such, cannot be categorized into one of the three risk categories because the amounts reported represent interest in the pool rather than ownership of specific, identifiable securities. However, all of the underlying securities within these investment pools are considered to be category 1 and are held by the custodian in the State's name. Category 1 is the highest level of safekeeping security as defined by GASB. The non-retirement domestic equity pool is an open-ended commingled investment pool which contains assets of other non-State institutional investors and, as such, cannot be categorized into one of the three risk categories because the amounts reported represent interest in the pool rather than ownership of specific identifiable securities.

The cost and fair value of the Plan's investments at June 30, 2003 and 2002 are as follows:

| | <u>Cost</u> | <u>Fair value</u> |
|---|-----------------------|--------------------|
| 2003: | | |
| Broad market fixed income pool | \$ 61,902,029 | 64,197,430 |
| Non-retirement domestic equity pool | 36,619,488 | 30,093,174 |
| Intermediate-term fixed income pool | 30,752,707 | 30,843,528 |
| State of Alaska international equity pool | 12,607,568 | 12,830,822 |
| | <u>\$ 141,881,792</u> | <u>137,964,954</u> |
| 2002: | | |
| Broad market fixed income pool | \$ 53,454,418 | 54,676,360 |
| Non-retirement domestic equity pool | 28,775,609 | 21,779,771 |
| Intermediate-term fixed income pool | 26,059,127 | 26,081,366 |
| State of Alaska international equity pool | 11,184,818 | 10,252,868 |
| | <u>\$ 119,473,972</u> | <u>112,790,365</u> |

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During 2003 and 2002, the Plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in value as follows:

| | <u>2003</u> | <u>2002</u> |
|---|---------------------|--------------------|
| Investments measured by quoted fair value in an active market: | | |
| Broad market fixed income pool | \$ 2,677,535 | 794,465 |
| Non-retirement domestic equity pool | 469,523 | (4,311,884) |
| Intermediate-term fixed income pool | 511,979 | (3,020) |
| State of Alaska international equity pool | (357,977) | (1,102,993) |
| | <u>\$ 3,301,060</u> | <u>(4,623,432)</u> |

(4) Pooled Investments

(a) Broad Market Fixed Income Pool

The Plan participates in an internally managed broad market fixed income pool (formerly known as the no-constraint fixed income pool). Not all participants in the pool are funds owned by the State of Alaska. The assets of the broad market fixed income pool are comprised of U.S. Treasuries, U.S. Government agency debt, corporate bonds, mortgage and asset backed securities, other U.S. dollar denominated bonds and an equity ownership in the short-term fixed income pool. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share on any given valuation date is determined by dividing the total market value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals

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from the pool are based on the net asset value per share on the day of the transaction. Investment securities in this pool have no maturity constraints. At June 30, 2003 and 2002, the Plan has a 7.69% and 5.75% direct ownership in the broad market fixed income pool totaling \$64,197,430 and \$54,676,360, respectively.

(b) *Non-Retirement Domestic Equity Pool*

The Plan participates in an externally managed non-retirement domestic equity pool. The pool holds shares in the Russell 3000 Index Common Trust Fund (Trust), a passively managed commingled index fund. When investing in this Trust the State of Alaska does not own individual securities but instead owns shares of the Trust, much like an investments in a mutual fund. The Trust includes other non-State institutional investors. The investment objective of the Trust is to replicate, as closely as possible, the return of the Russell 3000 Stock Index and thus is comprised of securities included in that index. Ownership in a common trust is based on the number of shares held by each participant. The net asset value per share on any given valuation date is determined by dividing the total market value of the net assets of the common trust by the number of shares of the common trust outstanding on the valuation date. Contributions to and withdrawals from a common trust are based on the net asset value per share on the day of the transaction. As of June 30, 2003 and 2002, the Plan has a 8.11% and 6.56% direct ownership in the pool totaling \$30,093,174 and \$21,779,771, respectively.

(c) *Intermediate-term Fixed Income Pool*

The Plan participates in an internally managed intermediate-term fixed income pool. Not all participants in the pool are funds owned by the State of Alaska. The assets of the intermediate-term fixed income pool are comprised of U.S. Treasuries, U.S. Government agency debt, corporate bonds, mortgage and asset backed securities, other U.S. dollar denominated bonds and an equity ownership in the short-term fixed income pool. The pool has an intermediate time horizon, a more limited need for liquidity than the money invested in the short-term fixed income pool, a limited need for inflation protection, and can be invested at a moderate risk level. The pool's duration, as measured by the weighted average time of cash flows for the underlying securities, will generally be close to that of the Merrill Lynch 1-5 year Government Index. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share on any given valuation date is determined by dividing the total market value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the net asset value per share on the day of the transaction. At June 30, 2003 and 2002, the Plan has a 1.66 % and 1.24% direct ownership in the intermediate-term fixed income pool totaling \$30,843,528 and \$26,081,366, respectively.

(d) *State of Alaska (SOA) International Equity Pool*

The Plan participates in an externally managed SOA international equity pool. Not all participants in the pool are funds owned by the State of Alaska. The assets of the pool are comprised of international equity securities, depository receipts, foreign currencies and an equity ownership in a short-term investment fund. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share on any given valuation date is determined by dividing the total market

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value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the net asset value per share on the day of the transaction. Investment securities in this pool have no maturity constraints. At June 30, 2003 and 2002, the Plan has a 12.75% and 10.17% direct ownership in the pool totaling \$12,830,822 and \$10,252,868, respectively.

(5) Claims Incurred But Not Paid

The liability for claims incurred but not paid represents the estimated amounts necessary to settle all outstanding claims, including those which are incurred but not reported, as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the health insurance business.

(6) Securities Lending

Alaska Statute 37.10.071 authorizes the Commissioner of Revenue to lend assets, under an agreement and for a fee, against deposited collateral of equivalent market value. In January 2001 the Commissioner of Revenue entered into an agreement with State Street Corporation (the Bank) to lend marketable debt and equity securities. The Bank, acting as the Commissioner of Revenue's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2003 and 2002, the fair value of securities on loan attributable to the Plan totals approximately \$18,520,000 and \$12,413,000. The Commissioner of Revenue is able to sell any securities out on loan. There is no limit to the amount that can be loaned. U.S. dollar denominated securities loans are fully collateralized at not less than 102 percent of their fair value. Non-U.S. dollar denominated securities loans are fully collateralized at not less than 105 percent of their fair value. The Bank invests the collateral in a commingled investment pool; maturities of these investments generally did not match the maturities of the loaned securities because the lending agreements were terminable at will. The Bank may pledge or sell collateral upon borrower default. Since the Commissioner of Revenue does not have the ability to pledge or sell the collateral unless the borrower defaults, no assets or liabilities are recorded on the financial statements. There is limited credit risk associated with the lending transactions since the Commissioner of Revenue is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank. The Bank and the borrower receive a fee from earnings on invested collateral.

For the years ended June 30, 2003 and 2002, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

(7) Contingency

The Plan is a defendant in four similar lawsuits, three of which are class action suits. The lawsuits pertain to whether changes in 1999 and 2000 to the retiree health insurance program under the Plan resulted in

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violations of members' constitutional rights to retirement benefits. The three class action suits were consolidated in 2001 and the Superior Court for Alaska issued an order granting the plaintiffs' motion for partial summary judgment. The likelihood of an unfavorable outcome is possible, however, the costs would be passed through to employers through the normal contribution process.

The State is a defendant in a lawsuit filed by the Alaska Civil Liberties Union and seven same-sex couples with regards to the statutes limiting health insurance coverage to employees and their spouses and dependents, thus excluding coverage for domestic partners of employees. An adverse ruling against the State would increase the number of persons that would be covered by insurance paid by the Plan.

Although the ultimate outcome of the litigation discussed above is uncertain at this point in time, the Plan believes that an unfavorable outcome, if rendered, would not have a material adverse effect on its financial position or funding status. The Plan has not recorded an accrual related to the above lawsuit, because an unfavorable outcome in this matter is, in management's opinion, not considered probable but rather only possible, and the potential loss, if any, cannot be reasonably estimated at this time.